Another 'pandemic' – worldwide inflation

By BIMAL KRISHNA and PROFESSOR TK JAYARAMAN

A money changer counts US dollar banknotes at a currency exchange office in Ankara, Turkey on November 11, 2021. Picture: REUTERS/Cagla Gurdogan/File Photo

Bank of England governor Andrew Bailey in London, Britain on February 25, 2019. Picture: Kirsty O'Connor/Pool via REUTERS

A picture illustration of the US dollar, Swiss Franc, British pound and Euro bank notes, taken in Warsaw on January 26, 2011. Picture: REUTERS/Kacper Pempel

WITH the emergence of a new, much more virulent and fast-spreading variant of COVID-19 virus, the Omicron, the world is in for another jolt.

This is the fear of rising inflation. Medical experts say that a more rapid coverage of population with two doses of vaccine would reduce severity of infection.

Further, an additional booster shot for the elderly and observance of wearing usual masks, social distancing and other precautions should be adequate.

What is feared most now is the worldwide impact of likely normalisation of monetary policies, contemplated in advanced countries.

Central banks are planning to end the two-year period of cheap money with low interest rates since May 2020 adopted to fight COVID -19 induced recession.

The impact on the rest of the world would be reversal of capital flows, known as hot money, always in search of higher returns.

They will destabilise the financial markets in emerging countries in particular and depreciate domestic currencies in general, as capital would like to return to safe havens, including US.

That will render essential imports which include food grains and cooking oil, petroleum products, construction equipment and commodities more expensive, leading to trade deficits and fall in growth, not to speak of value of domestic currency in terms of US dollar.

The US dollar is the currency which is used for payments to global suppliers.

Reasons behind inflation

The COVID-19 has wrecked world economy.

Loss of lives and livelihoods forced all governments to resort to fiscal stimulus efforts and cheap interest rate policy for fighting the virus-induced inflation and restoration of pre-pandemic levels of growth and development.

Success of these efforts was uneven. America did poorly and so too was Europe.

In fact many advanced countries did have negative growth rates in 2020, with deaths and fallen incomes and destitution all round, not caused by a drop of bomb, but by a virus.

A recovery of sorts began in mid 2021. But, it was only in some sectors.

Tourism had by then collapsed totally, though remittances helped a little but not sizeable enough to compensate.

While islands and small countries suffered a lot, advanced countries increased unemployment benefits and their handouts to poor families and tried to raise consumption which is nearly two-thirds of aggregate demand.

That helped sectors producing daily consumption to recover.

However, manufacturing sectors could not make the grade.

So, shortages showed up and supply chains disruption developed, due to cuts in crude oil as oil producing and exporting countries began to meet fall in demand for petroleum products, once COVID-19 induced recession engulfed the globe.

Adverse effects of supply disruption and shortage issues, accompanied by rise in commodity prices and rise in wages in US have pushed the inflation from 5.4 per cent in June 2021 to 6.8 per cent in November.

In Euro-zone, Germany registered the highest inflation, at 6 per cent in November since 1997, in both cases against the targeted rate of 2 per cent.

The latest IMF blog featuring former chief economist Raghuram Rajan and the present chief economist Gita Gopinath, brings out an interesting point about shift in demand for labour which caused wage increases.

They were due to preference for less human contact intensive but more skilled jobs.

The wage level has gone up for skilled jobs and for unskilled construction jobs as well, as shortages developed.

A study by Pew Research Centre says the inflation rate is "by no means solely a US concern".

In 39 out of 46 nations , the third-quarter 2021 inflation rate was higher than in the pre-pandemic third quarter of 2019.

Regardless of the absolute level of inflation in each country, many show variations on the same pattern: relatively low inflation before the pandemic hit, in the first quarter of 2020; flat or falling inflation for the rest of that year and into 2021, as many governments sharply curtailed most economic activity; and rising inflation in the second and third quarters of this year, as the world struggled to get back to something approaching normal.

The US Federal Reserve will be on a path of higher interest rates in the New Year, just a week its rate-setting committee would soon speed up to end expansionary monetary policy of near zero interest rate.

A week ago Bank of England (BoE), the mother of all central banks, became the first to raise interest rate.

It raised its bank rate to 0.25 per cent from 0.1 per cent.

Governor Andrew Bailey observed that though Omicron was already hurting the economy, BoE is compelled to "stop the recent jump in prices from becoming a longer-term problem".

The choice before them is between growth and price stability.

The Fiji situation

The *November 2021 Economic Review of the Reserve Bank of Fiji* reports that aside from the crude oil price hitting the ceiling at $US84.38 ($F178.70) per barrel in October, there were price swings because of the energy crisis in the gas and coal markets, reflecting supply chain disruptions and the impact of adverse weather conditions in the northern hemisphere.

However, there was volatility as price fell to $US72.72 ($F154.01) given the concern on fuel demand after the emergence of Omicron, the COVID variant.

The Food and Agricultural Organization food price index has been mounting.

It rose from 101.4 in October, 2020 to reach 129.2 in September, 2021 and 133.2 in October.

That is the highest level since July 2011.

It is driven by the increase in prices of vegetable oils and cereals on the back of strong global demand and supply concerns.

Fiji has adequate foreign reserves.

However, although there has been a decline from $3297 million in July 2021 (11.4 months imports equivalent) to $3180 million in September (11 months imports equivalent) and $3069.20 million (10.6 months imports equivalent).

The predicted headline inflation by the end of the year is 2 per cent and the forecast for 2022 is 2.5.

The RBF's interest rate has been accommodative at 0.25 per cent to support the economic recovery.

Eager traders and greedy hoarders are aware of the worldwide creeping inflation.

They may exploit the situation and bank credit may rise, fanning domestic inflationary potential. So, too real estate and housing sectors.

The recent warning by IMF is that in the context of supply-demand imbalances, continuing a monetary policy stance aimed at supporting recovery could fuel substantial and persistent inflationary pressures.

Their advice that in countries where economic recovery is underway with rising inflationary pressures, it would be necessary to accelerate the normalisation of monetary policy and ending easy money policy.

The advice may not apply to Fiji presently, as the recovery is slow.

However, vigilance is the need of hour. A preemptive action would be appropriate, when inflation pressures show up.

After all, a stitch in time saves nine.

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